SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 95

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

—v.—

THE SHAW-WALKER COMPANY,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

RESPONDENT'S MEMORANDUM IN RESPONSE TO THE PETITION

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32 CASE PRESS INC., 421 HUDSON ST., N.Y.—OREGON 5-4540

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The Commissioner of Internal Revenue has petitioned for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit which reversed the judgment of the Tax Court approving the assessment of the accumulated earnings tax upon Respondent, and remanded the case for further proceedings in that Court. The Petition requests that this Court:

> ". . . should hold this case pending the decision of *United States* v. *Donruss Co., supra.* [certiorari granted April 22, 1968; No. 17, October Term, 1968] In the light of that decision, it should either grant the petition and appropriately modify the judgment of the court of appeals, or deny the petition." (Petition, p. 7) (bracketed material added)

Respondent The Shaw-Walker Company does not oppose the granting of the Petition in this case. However, it does oppose the suggestion that this case, involving an extensive record germane to the question presented in both cases, should be disposed of by a decision in *Donruss* alone, on a record which is little more than a statement of the issue of law. It is respectfully requested that, if this Court grants the Petition, this case be consolidated for argument with the *Donruss* case in order to provide Respondent with an opportunity to be heard on the merits, and to provide this Court with an opportunity to consider the practical aspect of the issues involved.

Question Presented

When tax avoidance was neither the "dominant" nor the "controlling" nor the "impelling" motive for a corporation's decision to distribute only a portion of its earnings to shareholders, may that corporation nevertheless be held to have been "availed of for the purpose of avoiding income tax on its shareholders," under Section 532 of the Internal Revenue Code of 1954, 26 U.S.C. § 532, and therefore subject to the accumulated earnings tax?

Statement

Respondent is a Michigan corporation controlled by members of the Walker family and engaged in the manufacture and sale of office equipment (R. 707a-708a, 716a).*

* "R" references refer to the Appendix to Respondent's brief in the Court of Appeals. "App." references refer to the Appendix to the Petition for a Writ of Certiorari.

It began in 1899 with capital of less than $3,500 (R. 707a) selling card index systems, and has grown into what the Tax Court found to be an "active, complex nation-wide business" manufacturing and selling some 5,000 separate products (R. 766a). The Tax Court found that the working capital requirements of Respondent during the taxable years in question were determined by members of Respondent's management "based upon their knowledge and experience derived from close daily contact with . . . [Respondent's] business operations over a long period of years" (R. 769a; 713a-714a). Respondent distributed dividends ranging from $5.00 per share to $7.00 per share during the years at issue. It had paid substantial and increasing dividends during the preceding years (R. 743a) and had distributed much more of its cash flow than was the practice among the industrial groups into which it can be fitted for purposes of comparative statistical analysis (R. 309a-311a, 469a, 473a-476a, 598a-599a).

In 1960 the Commissioner assessed against Respondent total deficiencies of $1,580,366.50 in accumulated earnings tax for the taxable years 1955, 1956, and 1957 under the provisions of Sections 531 through 537, Internal Revenue Code of 1954, 26 U.S.C. §§ 531-37 (R. 25a-26a). Respondent petitioned for a redetermination of its liability by the Tax Court, which held the deficiencies were properly assessed because (i) the earnings retained by the Respondent exceeded the existing and anticipated needs of its business and (ii) the Company's retention of a portion of its earnings was for the purpose of avoiding the additional income tax on its shareholders which would have been imposed had it distributed all of its earnings (R. 706a-781a).

The Court of Appeals for the Sixth Circuit reversed, holding that the Tax Court's findings on the "economic" issues in this case (whether earnings retained exceeded those needed in the Company's business) were "clearly erroneous" (App. 6a, 13a). It further held the Tax Court had erred in failing to find whether or not the Company's decisions as to dividend distribution were based upon the "dominant, controlling, or impelling motive" of tax avoidance which the Court held was required for the imposition of the accumulated earnings tax (App. 17a). (citing *Donruss Co.* v. *United States,* 384 F.2d 292, 298 (6th Cir. 1967), *certiorari granted,* April 22, 1968; *Young Motor Co.* v. *Com'r,* 281 F.2d 488 (1st Cir. 1960); *Trico Products Corp.* v. *Com'r,* 137 F.2d 424 (2d Cir.) *cert. denied,* 320 U.S. 799 (1943))

The Court noted that:

> "As the Tax Court indicates, there are a number of factors which serve to weaken or strengthen the statutory presumption created by unreasonable accumulations. Among these factors are: expenditure of corporate funds for shareholder's personal benefit, withdrawals by shareholders of corporate funds as personal loans, and investment of accumulated corporate funds in unrelated activities. Another significant factor is the extent to which the corporation has distributed its earnings and profits. Treas. Reg. § 1.533.1." (App. 15a)

As noted by the Court of Appeals, the Tax Court explicitly found that Respondent had not loaned money to its shareholders to enable them to avoid or reduce income taxes, had never expended funds for the personal use of shareholders, had not made investments which were unrelated

to its business, and had distributed substantial dividends during the taxable years in question (App. 16a). Noting that the Tax Court apparently based its decision upon its finding that the Company's two largest shareholders were in high personal income tax brackets and would have been subject to substantial additional tax if the Company had distributed all rather than a part of its earnings, the Court of Appeals held that this finding was not a sufficient basis for concluding that the Company was managed for purposes of tax avoidance within the meaning of Section 532 (App. 17a).

ARGUMENT

The question raised by the Petition is whether the Court of Appeals was correct in holding that a corporation is not "availed of for the purpose of avoiding the income tax with respect to its shareholders" under Section 532 unless tax avoidance was the "dominant, controlling or impelling" motive for its corporate decision to distribute part rather than all of its earnings.

The practical problem presented in both the *Donruss* case and this case is the extent of the burden of proof a corporation must bear to prove, within the meaning of the statute, that it was not "availed of for the purpose of avoiding the income tax on its shareholders". The record in *Donruss* sheds little light on the practical merit of applying the rule proposed by the Commissioner that the accumulated earnings tax should be imposed where a company's decision to distribute only a part of its earnings was motivated by tax avoidance to *any* extent, rather than to a "dominant", "controlling" or "impelling" extent. The District Court

did not write an opinion in *Donruss*. That Court's views are reflected only in the charge to the jury, which contains little discussion of either the economic data or the evidence of purpose which was before the jury. *See* 65-1 U.S. Tax Cas. ¶9292 (W. D. Tenn. 1965). The opinion of the Court of Appeals in *Donruss* deals solely with the question of law. 384 F.2d 292 (6th Cir. 1967). The Appendix before this Court in *Donruss* sets forth almost no evidence as to the motives of The Donruss Company in connection with its allegedly improper accumulations, such evidence being limited to two financial tables and some brief excerpts from testimony explaining the tables. *Donruss* Appendix, pp. 9-15, Def. Exs. 48, 49.

Unlike *Donruss*, the *Shaw-Walker* case presents the issue of the proper construction of Section 532, a statute dealing with the living purposes of real people, against a record which demonstrates the direction of those purposes, and the tenacity with which they were pursued over two generations of a family's history. As noted above, the Tax Court found specifically in this case that none of the factors which the Treasury Regulations describe as indications of income tax avoidance were present in any degree. Indeed the record in *Shaw-Walker* goes further in demonstrating an absence of tax avoidance purpose. It shows that the Company rejected merger or other offers which would have permitted its shareholders to realize the economic benefit of the Company's undistributed earnings through tax free transactions or stock sales at capital gains rates (R. 374-378a, 651-689a). Since the Commissioner maintains this record is insufficient to carry the corporation's burden of demonstrating an absence of tax avoidance purpose, it

seems obvious that his construction of the statute would have far-reaching implications for many corporations.

This Court should consider the question presented, not in the evidentiary vacuum of the *Donruss* case, but rather in the context of the full record presented in this case.

CONCLUSION

For the foregoing reasons, Respondent respectfully requests that, if this Court grants the Petition herein, this Court consolidate this case for argument with the *Donruss* case.

June 28, 1968

Respectfully submitted,

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